

## Message Text

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ACTION EUR-12

INFO OCT-01 EA-07 ISO-00 CIAE-00 DODE-00 PM-04 H-02 INR-07

L-03 NSAE-00 NSC-05 PA-01 PRS-01 SP-02 SS-15 USIA-06

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USMISSION EC BRUSSELS

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AMEMBASSY TOKYO

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PASS TREASURY AND FRB

E.O. 11652: N/A

TAGS: EFIN, ECON, IT

SUBJECT: ROLE OF BANK OF ITALY IN POST-CARLI PERIOD

SUMMARY: WITH DEPARTURE OF CARLI FROM BANK OF ITALY AND TAKE-OVER BY NEW TEAM OF BAFFI, OSSOLA AND ERCOLANI, QUESTIONS ARISE RE NEW LEADERSHIP AND POLICIES. WHILE BAFFI REMAINS UNKNOWN QUANTITY, OSSOLA AND ERCOLANI CONSTITUTE STRONG TEAM. BANK EXPECTED TO CONTINUE TO FOLLOW CARLI'S LINE OF GIVING HIGH PRIORITY TO COMBATTING INFLATION AND MAINTAINING RELATIVELY LIMITED OFFICIAL USE

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STRONG B/P SITUATION. HOWEVER, ITS ABILITY TO CONTINUE THESE

POLICIES MAY BE IMPEDED BY GROWING CASH DEFICIT, INCREASING POLITICAL PRESSURE FOR COSTLY REFORMS AND EFFECTS ON B/P OF EXPECTED ECONOMIC RECOVERY. END SUMMARY

1. ON AUGUST 19 GUIDO CARLI OFFICIALLY RETIRED AFTER SERVING AN UNPRECEDENTED 15 YEARS AS GOVERNOR OF THE BANK OF ITALY (BOI). THE SUCCESSION TO CARLI CONSISTED OF THREE TOP BOI OFFICIALS MOVING UP ONE LEVEL, WITH PAOLO BAFFI BECOMING GOVERNOR, RINALDO OSSOLA DIRECTOR GENERAL AND MARIO ERCOLANI VICE DIRECTOR GENERAL. DURING HIS TENURE AS GOVERNOR, CARLI ASSUMED A LARGE MEASURE OF INDEPENDENCE FROM THE GOVERNMENT, EXERCISED CONSIDERABLE INFLUENCE OVER THE DIRECTION OF ITALY'S ECONOMIC AND FINANCIAL POLICIES, AND GAINED A POSITION OF WIDESPREAD RESPECT AS AN INTELLIGENT AND FORCEFUL LEADER. WITH THE DEPARTURE OF CARLI FROM THE SCENE, THREE IMPORTANT QUESTIONS ARISE: (A) TO WHAT EXTENT WILL NEW BOI LEADERSHIP SUCCEED IN MAINTAINING INFLUENCE AND INDEPENDENCE EXERCISED UNDER CARLI; (B) WHAT POLICIES WILL THEY WANT TO PURSUE; AND (C) HOW SUCCESSFUL WILL THEY BE IN PUTTING THESE POLICIES INTO PRACTICE?

2. CARLI'S SUCCESS IN ACHIEVING A NOTABLE DEGREE OF INDEPENDENCE WAS BASED NOT ONLY ON HIS PERSONALITY AND ABILITY, BUT ALSO TO A CONSIDERABLE EXTENT ON THE FACT THAT THERE WAS CONTINUITY AND COMPETENCE IN THE BOI DURING A PERIOD OF CHANGING AND OFTEN WEAK GOVERNMENTS. WHILE EXISTENCE OF SUCH GOVERNMENTS WAS MITIGATED BY FREQUENT FILLING OF TREASURY MINISTER PORTFOLIO BY TECHNICALLY COMPETENT EMILIO COLOMBO DURING THE 15 YEAR PERIOD, PREOCCUPATION OF TREASURY MINISTER WITH POLITICAL AS WELL AS ECONOMIC PROBLEMS STRENGTHENED HAND OF BOI GOVERNOR.

3. GOI PROMOTION OF BOI MANAGEMENT FROM WITHIN WAS PROBABLY ATTRIBUTABLE TO COMBINATION OF ITS (A) AWARENESS OF PUBLIC CONCERN THAT BOI REMAIN A RELATIVELY INDEPENDENT INSTITUTION AND (B) INABILITY TO FIND ALTERNATIVE CANDIDATE OR CANDIDATES WHO WOULD COMBINE MINIMUM QUALIFICATIONS WITH GENERAL POLITICAL ACCEPTABILITY. FAILURE OF GOI TO NAME FERDINANDO VENTRIGLIA, VICE PRESIDENT OF BANCO DI ROMA, TO SUCCEED CARLI REFLECTED OPPOSITION FROM POLITICAL PARTIES AND PRESS BECAUSE OF LIMITED OFFICIAL USE

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VENTRIGLIA'S CLOSE ASSOCIATION WITH DC AND PROBABLY RESISTANCE FROM WITHIN BOI (WHICH IN TURN MAY HAVE STEMMED FROM COMBINATION OF OPPOSITION TO AN OUTSIDER AND ONE WITH OBVIOUS STRONG POLITICAL TIES).

4. KEY FACTOR IN NEW EQUATION IS BAFFI. DESPITE HIS 15 YEARS AS NUMBER TWO TO CARLI, HE REMAINS VIRTUALLY UNKNOWN. HE HAS DONE SOME WRITING ON ECONOMIC ISSUES AND APPEARS TO BE TECH-

NICALLY COMPETENT; HOWEVER, HIS MODUS OPERANDI INSIDE BOI AND HIS PROBABLE REACTIONS TO NEW RESPONSIBILITIES CAN ONLY REMAIN SUBJECTS OF SPECULATION AT THIS TIME. ON HIS DEPARTURE CARLI TOOK SOME PAINS TO CONVINCE PUBLIC THAT BAFFI WAS STRONG-WILLED INDIVIDUAL WHO WOULD RESIST ANY EFFORT BY GOI TO ENCROACH ON INDEPENDENCE OF BOI. WHETHER THIS WAS STATEMENT OF FACT OR PIOUS HOPE, ONLY TIME CAN TELL. ON OTHER HAND OSSOLA IS WIDELY KNOWN AND RESPECTED AS IMAGINATIVE AND ARTICULATE EXPERT ON INTERNATIONAL FINANCIAL/MONETARY ISSUES. HE AND ERCOLANI CAN BE EXPECTED TO CONTRIBUTE TO MAINTENANCE OF HIGH QUALITY AND EFFECTIVENESS OF BOI.

5. INSOFAR AS POLICY PREFERENCES ARE CONCERNED, IT IS WIDELY EXPECTED THAT NEW BOI MANAGEMENT WILL SEEK TO FOLLOW SAME BASIC POLICIES AS THOSE PURSUED DURING CARLI REGIME. ALTHOUGH CARLI HAD STRONG PERSONALITY WITH EQUALLY STRONG VIEWS, HE DID ENCOURAGE DISCUSSIONS WITHIN BOI, WITH THE RESULT THAT BOI POLICIES PARTLY REFLECTED COLLEGIAL APPROACH. THUS, IT IS LIKELY THAT BOI WILL WANT TO CONTINUE TO FOLLOW POLICIES GIVING HIGH PRIORITY TO COMBATING INFLATION AND MAINTAINING RELATIVELY STRONG BALANCE OF PAYMENTS POSITION.

6. NONETHELESS, ABILITY OF BOI TO CONTINUE SAME POLICIES AS IN PAST MAY BE IMPEDED BY THREE FACTORS:

(A) GROWING CASH BUDGET DEFICIT, A FACTOR WHICH OVER PAST SEVERAL YEARS HAS MADE IT INCREASINGLY DIFFICULT FOR BOI TO CONTROL MONETARY EXPANSION AND RATE OF INFLATION.

(B) INCREASING POLITICAL PRESSURE FOR SOCIAL AND ECONOMIC REFORMS, AS EVIDENCED BY JUNE 15 LOCAL AND REGIONAL ELECTIONS. GOI AND POLITICAL PARTIES WILL BE UNDER STRONG PRESSURE, PARTICULARLY UNTIL PARLIAMENTARY ELECTIONS (SCHEDULED FOR SPRING LIMITED OFFICIAL USE

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1977), TO DEMONSTRATE DETERMINATION TO EFFECT ECONOMIC AND SOCIAL REFORMS, MANY OF WHICH COULD HAVE SERIOUS IMPACT ON ALREADY-LARGE BUDGET DEFICIT.

(C) PRECARIOUSNESS OF ITALY'S BALANCE OF PAYMENTS. IN VIEW OF SHARP AND CONTINUING INCREASE IN LABOR COSTS SINCE 1969 AND DRASTIC WORSENING OF ITALY'S TERMS OF TRADE IN 1973-74, IT IS QUESTIONABLE WHETHER RECENT MARKED IMPROVEMENT IN ITALY'S BALANCE OF PAYMENTS CAN BE MAINTAINED ONCE ECONOMIC RECOVERY BEGINS.

7. UNCERTAINTIES SURROUNDING BOI AS IT ENTERS POST-CARLI ERA WILL PROBABLY BEGIN TO DISAPPEAR IN COMING MONTHS AS DEVELOPMENTS RELATING TO FUTURE MORO GOVERNMENT, FATE AND EFFECTIVENESS OF GOI'S REFLATIONARY PACKAGE AND NATION-WIDE LABOR

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